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CC:CORP:06

PLR-133454-08

Date:

October 09, 2008

Legend

Distributing =

Controlled =

Sub1 =

Sub2 =

Sub3 =

LLC1 =

LLC2 =

LLC3 =

LLC4 =

LLC5 =

LLC6 =

P1 =

BusinessA =

BusinessB =

BusinessC =

Date1 =

Date2 =

Date3 =

Year1 =

Year2 =

StateA =

StateB =

ShareholderA =

ShareholderB =

ShareholderC =

ShareholderD =

ShareholderE =

PartyA =

a =

b =

c =

d =

e =

f =

g =

h =

i =

Dear :

This letter responds to your July 28, 2008, request for rulings on certain Federal income tax consequences of the series of proposed transactions described below (the "Proposed Transaction"). Additional information was submitted in letters dated September 17 and October 9, 2008. The material information submitted for consideration is substantially as set forth below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In

particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (described below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code (the “Code”) and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing was formed on Date1 as a StateA corporation and on Date2 elected under § 1362(a) to be treated as a subchapter S corporation (an “S corporation”) for Federal income tax purposes. At the time of the Proposed Transaction, Distributing will have approximately a dollars of accumulated C corporation earnings and profits from its pre-S corporation years.

Distributing has only common stock outstanding, the shares of which are held b-percent by ShareholderA, b-percent by ShareholderB, b-percent by ShareholderC, c-percent by ShareholderD, and d-percent by ShareholderE. ShareholderA, ShareholderB, and ShareholderC are siblings, and PartyA is their father.

Distributing wholly owns Sub1, a qualified subchapter S subsidiary disregarded as separate from its owner for Federal income tax purposes under § 1.1361-4(a)(i) (a “Q-Sub”). Sub1 wholly owns Sub2, also a Q-Sub, and LLC1, a limited liability company disregarded as a separate entity from its owner for Federal tax purposes under § 301.7701-3 of the Procedure and Administration Regulations (a “disregarded entity”). Sub1 also owns e-percent of the stock in Sub3, a corporation for Federal income tax purposes, and f-percent of the membership interests in P1, a partnership for Federal income tax purposes.

The Distributing group has two lines of business: BusinessA, which is conducted by Sub1, Sub2, LLC1, and Sub3; and BusinessB, which is conducted by Distributing and its direct and indirect subsidiaries (other than Sub1 and the entities owned by Sub1). The financial information submitted by Distributing indicates that BusinessA and BusinessB each have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. LLC2, a StateA partnership indirectly owned by ShareholderA, ShareholderB, ShareholderC, and PartyA, conducts BusinessC, a business that complements BusinessA.

On Date3, in a transaction unrelated to the Proposed Transaction, the shareholders of Distributing made pro rata cash contributions of approximately g dollars to Distributing in exchange for additional stock (the “Cash Infusion”).

Distributing management has determined that the Proposed Transaction will serve the following corporate business purposes: (i) remove regulatory restrictions that prevent BusinessA from offering its customers the same broad range of services currently being provided by its major competitors; and (ii) permit BusinessA to combine with BusinessC, conducted by LLC2, in a joint venture that will facilitate the expansion of BusinessA's customer services.

Proposed Transaction

To achieve the business purposes described above, the following series of steps is proposed:

1. Sub1 (currently a StateA Q-Sub) will convert to a StateA disregarded entity (the "Sub1 Conversion"), and Sub2 will convert to a StateB disregarded entity (the "Sub2 Conversion"). In the Sub1 Conversion and the Sub2 Conversion, all of the issued and outstanding shares of Sub1 and Sub2 will be cancelled and exchanged for membership units.
2. Distributing will transfer all of its membership interests in Sub1 to newly formed, wholly owned Controlled in exchange for all of the Controlled stock and the assumption by Controlled of related liabilities, as well as some debt of BusinessB (the "Contribution"). Distributing will immediately elect to treat Controlled as a Q-Sub.
3. Distributing will distribute all of the Controlled stock to its shareholders pro rata (the "Distribution").
4. Controlled will elect to be an S corporation under § 1362(a) immediately after the Distribution (the "S Election").
5. After the Distribution, Controlled and LLC2 will enter into a joint venture (the "Sub1 Joint Venture") using newly formed LLC6, a StateA LLC, as the joint venture vehicle (the "Joint Venture Formation"). In the Joint Venture Formation, Controlled will transfer all of its membership interests in Sub1 to LLC6 in exchange for a h-percent capital and profits interest, and LLC2 will cause LLC4 and LLC5 (which are disregarded entities owned by LLC3, a disregarded entity wholly owned by LLC2) to be contributed to LLC6 in exchange for the remaining i-percent capital and profits interest. LLC6 will not elect to be classified as a corporation for Federal tax purposes under Reg. § 301.7701-2(b)(2) and therefore will be treated as a partnership.

In connection with the Proposed Transaction, Distributing and Controlled will enter into agreements for support and transitional services (the "Transitional Services") and operational and business services (the "Ongoing Business Services"). The Transitional Services and Ongoing Business Services are collectively referred to as the "Continuing Transactions." The Transitional Services will consist of administrative support and corporate services (e.g., accounting, payroll, tax compliance) Distributing

will provide to Controlled for no more than 24 months while Controlled establishes its own support and service arrangements. In general, payment for these services will be based on the cost incurred by Distributing in making the services available. The Ongoing Business Services will relate to operational and business services that Distributing has chosen to obtain from Controlled, or that Controlled has chosen to obtain from Distributing, in each case as its third party vendor. The terms and conditions of these services will vary greatly and will be arrived at by the parties bargaining at arm's length (or will reflect terms and conditions comparable to those that would be arrived at by the parties bargaining at arm's length). Payment for the services will be based on their fair market value.

Representations

Distributing makes the following representations regarding the Proposed Transaction:

- (a) Distributing, Controlled, and each of the Distributing shareholders will pay his, her, or its own expenses, if any, incurred in connection with the Proposed Transaction.
- (b) Any indebtedness owed by Controlled (or any entity controlled directly or indirectly by Controlled) to Distributing (or any entity controlled directly or indirectly by Distributing) after the Distribution will not constitute stock or securities.
- (c) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (d) The five years of financial information submitted on behalf of BusinessB conducted by Distributing is representative of its present operations, and with regard to that business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of BusinessA that will be conducted by Controlled immediately after the Distribution is representative of its present operations, and with regard to that business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Neither BusinessB conducted by Distributing nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized in whole or in part, except for transactions that expanded BusinessB. Throughout the five-year period ending on

the date of the Distribution, Distributing will have been the principal owner of the goodwill and significant assets of BusinessB and will continue to be the principal owner following the Distribution.

- (g) Neither BusinessA that will be contributed to Controlled in the Contribution nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized in whole or in part, except for transactions that expanded BusinessA. From the time of its formation in Year1 until the Contribution, Sub1 will have been the principal owner of the goodwill and significant assets of BusinessA. Following the Contribution, Controlled will be the principal owner of the goodwill and significant assets of BusinessA.
- (h) Apart from the Continuing Transactions, Distributing will continue the active conduct of BusinessB, independently and with its separate employees, following the Distribution.
- (i) Apart from the Continuing Transactions, Controlled (through LLC4, a partnership controlled by Controlled) will continue the active conduct of BusinessA, independently and with its separate employees, following the Distribution.
- (j) The Distribution will be carried out to (i) remove regulatory restrictions that prevent BusinessA from offering its customers the same broad range of services currently being provided by its major competitors; and (ii) permit BusinessA to combine with BusinessC in a joint venture that will facilitate the expansion of BusinessA's customer services. The Distribution is motivated in whole or substantial part by these corporate business purposes.
- (k) The Distribution will not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (l) There is no plan or intention to liquidate Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business, or as described above as part of the Proposed Transaction.
- (m) The total adjusted basis and fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (as determined under § 357(d)) by Controlled and (ii) the total amount of any money and the fair market value of any

other property (within the meaning of § 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.

- (n) Any liabilities assumed (as determined under § 357(d)) by Controlled in the Contribution will have been incurred in the ordinary course of business and will be associated with the assets transferred, except for some debt relating to BusinessB that may be assumed by Controlled in an amount necessary to satisfy regulatory requirements.
- (o) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (as determined under § 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (p) The aggregate fair market value of the assets Distributing transfers to Controlled in the Contribution will equal or exceed the aggregate adjusted basis of these assets.
- (q) Distributing will neither accumulate its receivables nor make extraordinary payment of its payables in anticipation of the Contribution and Distribution.
- (r) No intercorporate debt will exist between Distributing (or any entity controlled directly or indirectly by Distributing) and Controlled (or any entity controlled directly or indirectly by Controlled) at the time of, or after, the Distribution, other than intercompany loans or obligations that have arisen, or will arise, between the parties in the ordinary course of business or as a result of the Continuing Transactions.
- (s) Except for payments made in connection with the Transitional Services, payments made in connection with all other transactions, if any, between Distributing (or any entity controlled directly or indirectly by Distributing) and Controlled (or any entity controlled directly or indirectly by Controlled) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length or terms and conditions comparable to those that would be arrived at by the parties bargaining at arm's length.

- (t) No two parties to the Distribution are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (u) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (v) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (w) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (x) Immediately after the transaction (as defined in § 355(g)(4)), either (1) no person will hold a 50-percent or greater interest (within the meaning of § 355(g)(3)) in Distributing or Controlled, (2) if any person holds a 50-percent or greater interest (within the meaning of § 355(g)(3)) in any disqualified investment corporation (within the meaning of § 355(g)(2)), such person will have held such interest in such corporation immediately before the transaction, or (3) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (y) Although the Cash Infusion occurred at a time when the Proposed Transaction was under consideration by Distributing and its shareholders, the contribution was made with respect to the needs of BusinessB and was unrelated to, and would have occurred regardless of, the Proposed Transaction.

- (z) Effective Date², Distributing made an election under § 1362(a) to be an S corporation (within the meaning of § 1361(a)), and Distributing has continued to be an S corporation since Year² (within the meaning of § 1361(a)).
- (aa) Immediately after the Distribution, Controlled will be eligible to elect S corporation status pursuant to § 1362(a), effective immediately after the Distribution.
- (bb) Controlled will elect to be treated as an S corporation, effective immediately after the Distribution (see § 1.1361-3(a)(4)).
- (cc) None of the persons holding stock, membership interests, or any equity interest in either Distributing or Controlled is or will be a nonresident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of § 1361(c)(2)).
- (dd) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be “a party to the reorganization” under § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders of Distributing on the Distribution (§ 355(a)).

- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each shareholder of Distributing immediately after the Distribution will equal the aggregate basis of the Distributing stock held by each shareholder of Distributing immediately before the Distribution, allocated between the stock of Distributing and Controlled in proportion to the fair market value of each immediately following the Distribution in accordance with § 1.358-2(a) (§ 358(b)(2) and (c)).
- (9) The holding period of the Controlled stock received by each shareholder of Distributing in the Distribution will include the holding period of the Distributing stock on which the Distribution is made, provided the Distributing stock was held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).
- (11) The momentary ownership by Distributing of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to make a subchapter S election under § 1362(a) for its first taxable year, provided such election is made effective immediately after the Distribution.
- (12) Controlled will be subject to § 1374 with respect to any asset transferred from Distributing to Controlled to the same extent that Distributing is subject to § 1374 with respect to such asset. For purposes of § 1374, Controlled's recognition period will be reduced by the portion of Distributing's recognition period that expires prior to Distributing's transfer of these assets to Controlled (§ 1374(d)(8) and Announcement 86-128, 1986-51 I.R.B. 22).
- (13) Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under § 312(h) (see §§ 1.312-10(a) and 1.1368-2(d)(3)).

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of

§ 1.355-2(b);

- (ii) Whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both;
- (iii) Whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii);
- (iv) Whether Distributing is a valid S corporation; and
- (v) Whether Controlled is otherwise eligible to be an S corporation.

Procedural Matters

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this ruling letter must be attached to the federal income tax return of each party involved in the Proposed Transaction for the taxable year in which the Proposed Transactions are completed. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their returns that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Alfred C. Bishop
Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: